SDRS SQUARE DEAL RECORDINGS & SUPPLIES

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June 6, 2000

Federal Trade Commission
Office of the Secretary
600 Pennsylvania Ave. NW
Washington, DC 20580

To: FTC Commissioners
From: Richard W. Ferris, President, Square Deal Recordings & Supplies
RE: M.A.P. (Minimum Advertised Price) and FTC staff rulings

Dear Commissioners,

I write you this letter in hopes that your wisdom, experience and knowledge on the subject will be sufficient to disregard staff's recommendation regarding elimination of M.A.P. for the record industry.

Not being there for testimony or having any ability to know what staff has for input I presume that staff's recommendations are based upon their ignorance of the record business and how it actually works. Perhaps they have been fed a line of malarkey from the usual special interests, but for staff to recommend elimination of M.A.P. and the disruption it would cause in the marketplace for everybody but the largest of players makes no logical sense.

Some background on who I am. I have been in the record business as an independent retailer and independent distributor for almost 30 years. We've operated retail stores and done distribution throughout the United States. I have long term knowledge and experience about how the industry operates from the inside, which does not necessarily coincide with the rhetoric from the proponents of eliminating M.A.P.

Prior to M.A.P., many record chains built their empires by opening a store in a market with independent retailers. The chain would then run that store at prices below the independent retailer's costs, letting the new store lose money and be subsidized by their other stores. Once the local retailers were put out of business by these practices, the pricing went up to normal pricing. The large chain called "Wherehouse Records" built its empire on the west coast by this very procedure. Their use of this technique was so widespread it eventually resulted in legislation in California requiring advertisement to be at 6 percent above cost and further requiring when chains open a new store and run a sale they must run it for all chain locations in that region.

Part of the tool that chains use to take unfair advantage of independent retailers is co-op advertising. Co-op advertising in the record business is loosely based upon purchases; however, the formula that the chains get and the formula that the independent gets seem to be radically different. Chain stores seem to get between 1½ and 3 percent of the initial purchases in co-op advertising. Independent stores seem to get ½ percent to 1 percent at best in co-op advertising (co-op advertising in the record business is such that the record label pays 100 percent of the advertising expenses).

In the bad old days, prior to M.A.P., a large chain or non-music retailer would place a huge purchase order for product, often *far in excess of what they actually anticipated selling*. This would generate them an extremely large co-op advertising credit which they could then run to promote their new store opening. Frequently they would run the product at below their competitors' costs, using the record companies' money to help run the little guys out of business. At the end of the billing period the large chains would frequently return a significant part of their purchases for credit, thereby increasing their up to 3 percent advertising allowance to a net of 6 percent after returns were deducted (again, comparing this to independent stores who are lucky to get ½ to 1 percent).

Once M.A.P. happened, the large chains could of course still run merchandise at any price they wanted to; however, they had to spend their money on the advertising, not the record companies'. Once this was put into effect, the <u>normal</u> <u>market</u> <u>factors</u> that relate to selling stuff below cost and then spending money on advertising to do it took effect and manufacturer subsidized lowball pricing below cost went away.

Now the FTC is in the picture at the request of large chains that wish to use sound recordings as a loss leader. It's not enough that the record industry operates on the tightest margins of any retail industry outside of grocery stores and always has. It's not enough that the big chains have succeeded in dominating the record industry to the extent that more than two-thirds of the independent retailers have already been eliminated. It's not already too much that the last time the low-ballers had record company money to throw at their competitors, more than eleven regional chains had to file for chapter 11 bankruptcy.

Allowing big box chains the unique situation of 100% paid co-op advertising (no other industry has 100% paid co-op), to lure customers with *artificially low* music prices only to enjoy better mark-up than they otherwise could on their normal product lines is WRONG. How does the fed's intervention, thereby allowing a national campaign of bait (low music prices) and switch, (higher than otherwise prices on the store actual major lines of wares) help consumers?

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By eliminating M.A.P. the FTC is costing consumers huge amounts of money:

1. Chains that would normally compete by lowering prices on their major lines instead "give away" music. The dollar or so save on music is more than offset by the tens of dollars in increased prices paid by consumers on most other products.

2. When music is "whored" by non-music retailers, actual music retailers and the public suffer. By reducing the legitimate retailer's volume his prices cannot be as competitive. By reducing his sales volume by low-balling he cannot support the same selection (low-ballers sell only top sellers) the public then loses actually full line retailers, their selection and their competitive prices.

3. Ask yourself honestly why there are legal actions to sell at or below cost. Follow the money—it's done to overall cost consumers more, not save the money. Remember that's how and why all the money is being spent to eliminate M.A.P. (It's not being done to save consumers money. That's the deceptive, misleading rhetoric you must see through!)

This case has nothing to do with protecting consumers! The large labels are effectively a federally sanctioned monopoly and they are continuously raising both list price and wholesale costs for each price category.

This case has nothing to do with saving consumers money. By allowing large chains to loss leader sound recordings (using the record companies' money) to sell other products at prices higher than otherwise does not help the consumer. If, instead of selling sound recordings below or at cost, the large non-music chains discounted their own major lines to lure consumers, consumers would save far more.

It is hard for me as a retailer with many years' experience to understand why the federal government feels it has a role in this action. The marketplace has put reasonable controls on the conduct of all the players to eliminate the abuse and at least a small amount of the unfair advantage chains have over independents. But apparently the large money at the discretion of the large chains, the number of lawyers and legal amount they are willing to spend, is enough to buy the FTC.

Please help us! Do not put the federal government in a position where it intentionally is raping all the independent record one-stops and retailers for the benefit of the big chains in America.

PLEASE do not remove M.A.P., the only thing that keeps chains that aren't even in the record business from taking our product line, running it below our cost as a loss leader to sell other lines of merchandise. This was the fact that bookstores and other non-music stores were taking sound recordings and selling them below cost, using the record company money to pay for the ads was the other major reason that M.A.P. was put in place in the first place.

Please remember that in a free country market solutions are almost always better than top-down bureaucratic solutions. The local knowledge it takes to see how things actually work and to deduce cost and effect relationships are frequently not available to the bureaucrats, technicians and other people at federal levels. However there certainly are plenty of high-paid lawyers, expensive lobbyists and other special interests there to promote their own needs. Please, be our commissioners and represent the good of all citizens, not just the chains. The chains aren't going to lower record prices per se, they are merely going to use them as loss leaders at the expense of legitimate retailers. They are trying to lure customers to prices that are kept higher than normal because it's music that's the draw, not the prices of the actual main line of merchandise they sell.

Is there another industry the federal government would go to the special problem to rape in order to allow other industries to use it as a loss leader for their lines?

Please do not act against M.A.P. Please do no harm.

Sincerely,

Richard W. Ferris Pres

Richard W. Ferris, President
Square Deal Recordings & Supplies

CC: U.S. Senate Committee on Commerce, Science and Transportation
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